National Agricultural Development Co (NADEC)

2Q19 Preview

16 July 2019

Not All Gloom After Merger Canceled

SAR 34 — 12-Month Target price

Buy — Recommendation

Merger with ASD was called-off last month, resulting in our revised target price of SAR 34, previously SAR 40. However, we believe it's not all doom and gloom, as the Company mounted topline resurgence in 2H18. Our value case hinges on durable topline growth, which the market is not currently pricing. Nadec shares trade 0.9x forward sales – a significant discount to competitors SADAFCO and Almarai. Even a modest profit should be viewed as a victory – we are looking for SAR 0.15 EPS (-34% Y/Y). Reiterate Buy.

Topline recovery will drive value case

Since Almarai raised fresh dairy prices last summer, Nadec's revenues have mounted a recovery thanks to market share gains. We expect the trend to continue in 2Q19 with a boost from Ramadan as revenues reach SAR 589 mln (+5% Y/Y). Interestingly, prices are expected to edge higher as competitors focus on margin maintenance. This will give Nadec more breathing room, resulting in price-driven revenue gain, even if volumes moderate. We highlight that Nadec shares trade 0.9x 2020E revenues vs 2.1x for SADAFCO and 3.7x for Almarai – suggesting that market is not pricing-in sustained topline recovery. We, on the other hand, believe that Nadec can deliver at least similar growth as SADAFCO next year.

Margins should benefit from continued cost control

Phase-out of agricultural activities should provide some improvement in fixed costs, which will be distributed over higher revenue base. As a result gross margin could at least sustain last year's level, despite higher alfalfa and personnel costs. We caution that substitution to 100% imported alfalfa could compound margin pressure, in concert with higher material and energy costs.

Reporting a profit will be a victory of sorts

We had previously expected uphill battle to remain profitable post-F2018 on declining revenues and rising costs. Then the merger with ASD was announced creating scope for scale and efficiencies, which could enable the combined entity to gain market share and optimize distribution network. Since 2H18, Nadec benefitted from pricing strategy and gross margin improvement. If this continues, we see a path to sustainable profitability. Therefore, even a modest profit in 2Q19 will be viewed as a victory of sorts. We are looking for SAR 13 mln (-34% Y/Y) in earnings.

Capex expected to remain in check, unlocking value

Echoing Almarai, Nadec is also rationalizing capex, reflective of current market conditions. This should free-up cashflow. While we cut our target price to SAR 34, from SAR 40, given that ASD merger is off-the-table, we hinge our value case on durable topline. Nadec trades at a discount, 9.3x 2020E EV/EBITDA vs SADAFCO (10.6X) and Almarai (16.1x). Reiterate Buy.

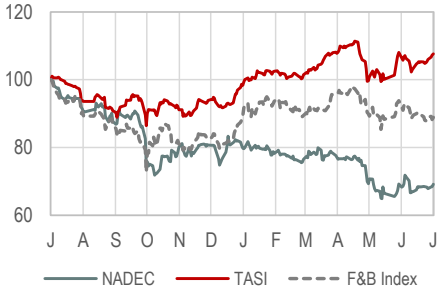
NADEC (SAR mln)	2Q19E	2Q18	Y/Y Chg	1Q19	Q/Q Chg
Revenues	589	560	5.2%	530	11.0%
Gross profit	223	212	4.8%	203	9.5%
Gross margin	*37.8%*	*37.9%*		*38.3%*	
EBITDA	112	107	4.4%	95	17.1%
EBITDA margin	*19.0%*	*19.1%*		*18.0%*	
Operating profit	42	40	5.4%	38	12.2%
Operating margin	*7.2%*	*7.1%*		*7.1%*	
Net income	13	20	-33.5%	-4	n.m.
Net margin	*2.2%*	*3.5%*		*-0.7%*	
EPS (SAR)	0.15	0.23	-33.5%	(0.04)	n.m.

Stock Details		
Last Close Price	SAR	24.46
Upside to target	%	39.0
Market Capitalization	SAR mln	2,072
Shares Outstanding	mln	85
52-Week High	SAR	35.40
52-Week Low	SAR	22.82
Price Change (YTD)	%	(16.9)
3-Mth ADTV	thd	195
EBITDA 2019E	SAR mln	431
Reuters / Bloomberg	6010.SE	NADEC AB

SAR mln	2018	2019E	2020E
Revenues	2,096	2,220	2,297
Gross Margin	37%	37%	37%
EBIT	72	142	155
Operating Margin	3.4%	6.4%	6.7%
Net Income	2	12	18
Net Margin	0.1%	0.5%	0.8%
EPS (SAR)	0.02	0.14	0.21

Price Multiples	2018	2019E	2020E
P / E	n.m.	n.m.	n.m.
EV / EBITDA	11.5x	9.1x	9.3x
P / S	1.0x	0.9x	0.9x
P / B	1.4x	1.4x	1.4x

1-Year Share Performance (Rebased)



Source: Bloomberg, Tadawul, SFC

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